COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. .....

ROBERT M. DIGGS and CLARA C. DIGGS,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ROBERT M. DIGGS,
CLARA C. DIGGS,
Petitioners, Pro Se,
1400 Buchanan Avenue,
Olean, New York.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered on July 5, 1960.

Opinions Below

The opinion of the Tax Court of the United States is reported at T. C. Memo 1959-99 and a copy is printed in the Appendix to Main Brief of Petitioners in the Court of Appeals at page 3. The opinions of the Court of Appeals are reported at _____ F. (2d) ___, ___, 6 AFTR (2d) 5095 and a copy is printed as Appendix A, *infra*, p. 10.

Jurisdiction

The judgment of the Court of Appeals was rendered on July 5, 1960 and was entered by the Clerk on the same day. A copy is printed as Appendix B, *infra*, p. 22. The jurisdiction of this Court is based on 28 U. S. C. § 1254 (1).

Questions Presented

1. Whether amounts paid to an insurance company as interest on loans secured by deferred annuity contracts purchased before March 1, 1954 are deductible from gross income for federal income tax purposes.

2. Whether losses from accidental breakage of glassware and china from the application of sudden, violent, external physical force are deductible from gross income for federal income tax purposes.

Statutes Involved

The statutes directly involved in this proceeding are Section 23(b) of the Internal Revenue Code of 1939, 53 Stat. 12 (1939), 26 U. S. C. A. (I. R. C. 1939) § 23(b) (1955):

> "**§ 23. Deductions from gross income.** In computing net income there shall be allowed as deductions:
> * * *
> "**(b) Interest.** All interest paid or accrued within the taxable year on indebtedness, * * *"

and Section 23(e) (3) of the Internal Revenue Code of 1939, 53 Stat. 12 (1939), 26 U. S. C. A. (I. R. C. 1939) § 23 (e) (3) (1955):

> "**§ 23. Deductions from gross income.** In computing net income there shall be allowed as deductions:
> * * *
> "**(e) Losses by individuals.** In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
> * * *

"(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwrecks, or other casualty, or from theft. * * *"

Also relevant to this case are: Section 24(a) (6) of the Internal Revenue Code of 1939, added by 56 Stat. 827 (1942), 26 U. S. C. A. (I. R. C. 1939) § 24(a) (6) (1955); Section 163 (a) of the Internal Revenue Code of 1954, 68A Stat. 46 (1954), 26 U. S. C. § 163(a) (1958 ed.); Section 264(a) (2) of the Internal Revenue Code of 1954, 68A Stat. 77 (1954), 26 U. S. C. § 264(a) (2) (1958 ed.); and Section 23(a) (2) and Section 23(e) (2) of the Internal Revenue Code of 1939, 53 Stat. 12 (1939), 26 U. S. C. A. (I. R. C. 1939) § 23 (a) (2) and 23 (e) (2) (1955). These sections are printed in Appendix C, *infra*, p. 23.

Statement of the Case

Petitioner Robert M. Diggs (herein referred to as "Petitioner") in the Fall of 1951 was unmarried, 39 years old and had a net worth of approximately $400,000, with an expectation of receiving approximately $600,000 additional at the death of his mother, who was then 72 years old and in good health. In those circumstances Petitioner purchased from Standard Life Insurance Company of Indiana two deferred annuity contracts, each calling for payment of annual premiums of $5,000 and providing for annuities of $3,113.18 monthly commencing 41 years from the date of issue, with the privilege to Petitioner of receiving annuity or lump sum cash payments at an earlier date and of borrowing up to the cash value of the contract at the time to which interest was paid. After paying the initial premiums Petitioner borrowed $236,856.72 from Girard Trust Corn Exchange Bank of Philadelphia, secured by assignments of the two annuity contracts. That bank credited the pro

ceeds of the loan to the account of the insurance company, which received the same as prepayment of the premiums on the annuity contracts for 40 years in advance. The prepayment of the premiums for 40 years in advance created a cash value of $122,303 in each contract as of December 12, 1952. Petitioner thereupon borrowed $244,606 from the insurance company on the sole security of his contracts, paying interest of $9,596.08 to December 12, 1952 on the amount borrowed. The proceeds of these loans were used to discharge Petitioner's note to the Philadelphia bank, and he received the surplus of $7,749.28.

In 1952 Petitioner paid $9,784.24 to the insurance company, representing interest at 4% from December 12, 1952 to December 12, 1953 on $244,606.

Meanwhile, on February 19, 1952 Petitioner had married Clara C. McLeod, who had an approximate net worth of $200,000 to $250,000, and who had three dependent children. Shortly after their marriage Petitioners started planning a home, construction of which was started in September, 1952. Thereafter Petitioner sold securities to pay for the construction costs, realizing substantial capital gains. Relying on the approval of the deduction on his 1951 return, Petitioner determined to continue his program of selling securities to finance the home construction, and to offset partially the resulting capital gains paid interest for three years in advance on the cash value of the annuity contracts as of December 12, 1956, increasing the loans from the insurance company to the full extent of such cash value. The total amount of the interest payments in 1953 was $32,903.28, while Petitioner realized $213,176.40 from the sale of securities in 1953, with a net capital gain of $80,585.71.

Petitioner sustained losses from the breakage of glassware and china as follows:

1952—glassware and china broken by Petitioner while moving household goods from an apartment to a rented house, $175; glassware broken by domestic servants, $50.

1953—glassware broken by striking a water faucet, $7.50; glassware broken by a cat, $62.50; glassware broken by domestic servants, $12.50; glassware broken by sudden application of heat, $6.75.

All of these losses represent the reasonable value of the items involved, all resulted from the application of sudden, violent, external physical force. No part of the losses was recovered through insurance or salvage.

Petitioners deducted the interest payments of $9,784.24 in 1952 and $32,963.28 in 1953 and the losses of $225 in 1952 and $89.25 in 1953 from their gross income in their federal income tax returns for those years. Respondent disallowed the deductions and found deficiencies of $5,155 for 1952 and $18,132.60 for 1953. Petitioners filed a petition for redetermination of the assessments with the Tax Court of the United States, which determined that there were deficiencies as found by Respondent. On petition for review the Court of Appeals affirmed the decision of the Tax Court. Review of the judgment of the Court of Appeals is sought by this petition.

Reasons for Granting the Writ

1. With respect to the deductibility of the payments to the insurance company, this Court has already decided to review the question in *Knetsch v. United States*, 361 U. S. 958 (1960), and the interests of justice dictate that these Petitioners be accorded equal treatment. In addition, the

more complete record in the present case will afford the Court a more adequate opportunity to give full consideration to the question.

Three other Courts of Appeals have already considered the basic question presented by this aspect of the present case. The Fifth Circuit decided that such payments were deductible, *United States v. Bond*, 258 F. (2d) 577 (1958). The Third Circuit in *Weller* and *Emmons v. Commissioner of Internal Revenue*, 270 F. (2d) 294 (1959), and the Ninth Circuit in *Knetsch v. United States*, 272 F. (2d) 200 (1959) have reached the contrary result. While there are some factual differences in each case, all have been recognized to involve the same issue, and this Court has already granted certiorari in the *Knetsch* case, 361 U.S. 958 (1960), and petitions have been filed in the *Weller* and *Emmons* cases. Thus this Court has determined that it should consider the question and resolve the conflict. Since the purpose of this Court's exercise of its jurisdiction to resolve conflicts among the Courts of Appeals in the various Circuits is to approach uniformity in the administration of law, it is apparent that this policy would be promoted by granting this petition and thus avoiding the manifest unfairness which would result from requiring these petitioners to pay the deficiencies which have been determined even though this Court should decide the *Knetsch* case in favor of the taxpayer.

The other cases raising the same question have been presented largely upon stipulated facts. In the present case, however, an expert witness explained the nature of the payments, the insurance company was examined concerning its handling of the transaction and the taxpayer testified fully about the handling of the transactions and the motivating factors underlying his decisions. The re-

sulting more complete record may give this Court a more thorough understanding of the nature of the payments and a broader basis for reaching a conclusion as to their deductibility.

2. With respect to the losses from breakage of glassware and china, although the amount involved is not significant, the question presented is of universal application and should be settled by this Court because of its general importance and because there is an unresolved difference of opinion among the Courts of Appeals for the various circuits as to the meaning of "other casualty" in the statutory provision authorizing the deduction of casualty losses.

Both Section 23(e) (2) of the Internal Revenue Code of 1939, 53 Stat. 12 (1939), 26 U. S. C. A. (I. R. C. 1939) § 23(e) (3) (1955) and Section 165(c) (3) of the Internal Revenue Code of 1954, 68A Stat. 49 (1954), 26 U. S. C. § 165(c) (3) (1958 ed.) permit the deduction of individual losses arising from fire, storm, shipwreck, or other casualty, or from theft. Although the other terms have a reasonably definite and well understood meaning, the term "other casualty" has proved difficult to define, and its administrative and judicial application impossible to predict.

For example, damage to residential property from an unusual and unexpected drought[1] and from unusual weather[2] has been held deductible, but not the loss of a well drying up during a drought.[3] Freezing damage to a boiler[4]

[1] Rev. Rul. 54-85; I. R. B. 54-10; Ruling letter to Sen. Henning, P-H, Fed. 1954 ¶ 76, 570; *Buttram v. Jones*, 87 F. Supp. 322 (W. D. Okla. 1943).

[2] *Hessler v. Commissioner of Internal Revenue*, T. C. Memo. P-H ¶ 54, 282.

[3] Rev. Rul. 55-327, 1955—1 C. B. 25.

[4] I. T. 2231, IV-2 C. B. 54.

and from bursting pipes as well as to trees and shrubs[6] has been held deductible, but not damage from corrosion and rust.[7] Damage from bombardment[8] and blasting[9] has been held deductible, but not from vandalism.[10] There have been decisions both ways in cases of damages by termites, the deductions being allowed upon a showing of a sudden invasion[11] but denied when there was no proof that the damage did not occur gradually over a period of time.[12] Damage by moths[13] and by rats[14] has been held not deductible. Damage to an automobile by a child's pushing the starter button has been held deductible,[15] but not the accidental breakage of a watch.[16]

If there is any *rationale* which would reconcile most of the apparent confusion, it would seem to be that to qualify as a casualty loss the damage must result from a sudden event, involving violent physical force of an unusual or accidental character. If this is the test, the losses claimed or at least nearly all of them, should have been allowed

[6] O. D. 1076, 5 C. B. 138.

[7] *Montgomery v. Commissioner of Internal Revenue*, T. C. Memo, P-H ¶ 47,017.

[8] *Matheson v. Commissioner of Internal Revenue*, 54 F. (2d) 537 (C. C. A. 2d 1931).

[9] I. T. 3519, 1941—2 C. B. 96.

[10] *Purdon v. Commissioner of Internal Revenue*, 3 T. C. 1 (1944).

[11] *Banigan v. Commissioner of Internal Revenue*, T. C. Memo, P-H ¶ 51, 177.

[12] *Rosenberg v. Commissioner*, 198 F. (2d) 36 (C. A. 8th, 1952); *Shopmaker v. United States*, 119 F. Supp. 705 (E. D. Mo. 1953); *Buist v. United States*, 164 F. Supp. 218 (E. D. S. C. 1958).

[13] *United States v. Rogers*, 120 F. (2d) 244 (C. C. A. 9th, 1941); *Fay v. Commissioner of Internal Revenue*, 42 B. T. A. 206 (1940), aff'd, 120 F. (2d) 253 (C. C. A. 2d 1941); *Feinstein v. United States*, 173 F. Supp. 893 (E. D. Mo. 1954).

[14] Rev. Rul. 55-327, 1955—1 C. B. 25.

[15] *Banigan v. Commissioner of Internal Revenue*, T. C. Memo, P-H ¶ 51, 177.

[16] *Leet v. Commissioner of Internal Revenue*, T. C. Memo 1955-13.

[17] *Thompson v. Commissioner of Internal Revenue*, 15 T. C. 609 (1950), rev'd on other grounds, 193 F. (2d) 586 (C. A. 10th, 1951).

and the decision sought to be reviewed is wrong. This Court has not yet considered what constitutes a deductible casualty loss, and it is submitted that the question is of sufficient general importance and the subject of such widespread uncertainty as to be worthy of review by this Court even though the amount involved in this particular case is relatively trivial.

Conclusion

This Court should grant the petition to review both questions raised by the record.

Respectfully submitted,

ROBERT M. DIGGS,
CLARA C. DIGGS,
Petitioners.

APPENDIX A

Opinions of the Court of Appeals

ROBERT M. DIGGS and CLARA C. DIGGS,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

U. S. Court of Appeals, Second Circuit, No. 25872. July 5, 1960.

Robert M. Diggs, Clara C. Diggs, Olean, New York, *pro se.*

Howard A. Heffron, Actg. Asst. Atty. Gen.; Melva M. Graney, Lee A. Jackson, Harry Baum, Grant W. Wiprud, Atty., Dept. of Justice, Wash., D. C., for Respondent.

Before Clark, Waterman and Moore, Circuit Judges.

Taxpayer petitions for review of a decision of the Tax Court, Mulroney, J., denying deductions claimed under Section 23(b) of the 1939 Internal Revenue Code for payments taxpayer made to insurance company and deductions claimed for alleged casualty losses. Decision of Tax Court affirmed.

WATERMAN, Circuit Judge:

Petitioner Robert M. Diggs[1] seeks review of a decision of the Tax Court denying his claims for deductions under Section 23(b) of the Internal Revenue Code of 1939 for pay-

[1] Petitioner Clara C. Diggs is a party to this litigation solely because, having married petitioner Robert M. Diggs on February 19, 1952, the tax returns for the years in controversy, 1952 and 1953, were joint returns.

ments be made in 1952 and 1953 to the Standard Insurance Company of Indiana. These payments purported to be payments of interest upon a debt created when Standard loaned petitioner an amount necessary to prepay premiums on two annuity contracts Standard had issued to petitioner. The Tax Court's approval of the Commissioner's disallowance of petitioner's claimed interest deductions was based upon its decisions in W. Stuart Emmons, 31 T. C. 26 (1958) and Carl E. Weller, 31 T. C. 33 (1958), decisions affirmed by the Third Circuit in a single opinion, Weller v. CIR, 270 F. 2d 294 [4 AFTR 2d 5453] (3rd Cir. 1959), cert. . . U. S. . In Weller, at page 299, the Third Circuit rejected the majority reasoning of the Fifth Circuit in the earlier case of United States v. Bond, 258 F. 2d 577 [2 AFTR 2d 5314] (5th Cir. 1958), wherein arguments for deductibility similar to petitioner's contentions here were sustained by a divided court. More recently, in Knetsch v. United States, 272 F. 2d 200 [4 AFTR 2d 5855] (9th Cir. 1959), cert. granted, 36 U. S. 958, 80 S. Ct. 589 (1960) the Ninth Circuit followed the Third Circuit in Weller, and expressly rejected the Fifth Circuit's position in Bond. We agree with the results reached by our colleagues of the Third and Ninth Circuits.

The Tax Court's findings of fact in the present case have not been challenged and are detailed below. Petitioner, at some time immediately prior to December 12, 1951, purchased two 41 year deferred annuity contracts. Each contract called for a $5,000 annual premium, and each entitled the annuitant to monthly payments of $3,113.18 commencing on December 12, 1992. Petitioner paid the initial premiums. Then, on December 24, 1951, he borrowed from the Girard Trust Corn Exchange Bank of Philadelphia a sum of $236,856.72, representing a discounted prepayment of the remaining premiums which would otherwise have

been payable $10,000 a year for 40 years, on the two contracts, which contracts were used as security for the loan. The bank then credited the loan proceeds to the account of Standard. As a result of the payment of the initial premiums and of this 40-year prepayment of premiums the total present cash value of the two contracts became $244,606. Two days later, on December 26, 1951, at petitioner's request, Standard sent the bank two checks of Standard equal to the amount of the bank loan and in full payment thereof. Also, at petitioner's request, and pursuant to an option in the contract permitting the annuitant to borrow up to the cash value of the contract, Standard issued to petitioner its checks totaling $7,749.28, thereby increasing Standard's loan to petitioner from the $236,856.72 Standard paid the bank to the full cash value of the contract, $244,606. This loan, pursuant to the terms of the annuity contract, was to be without recourse, the contracts themselves constituting the sole security, and was to require an annual interest charge of four per cent. On the same day, December 26, 1951, petitioner paid Standard $9,596.08 as a prepayment of this 4% interest on the $244,606 loan for one year, or until December 12, 1952.[2] In December 1952, petitioner paid Standard $9,784.24 as prepayment of interest for the year, or until December 12, 1953. On September 1, 1953, the present cash value of the contracts having increased, petitioner notified Standard of his intention to increase his loan up to the increased cash value as of December 12, 1953, or $253,464; and he enclosed a check for $88.60 as prepayment of interest on the increase of the face of the loan, $8,858., for the period from September 1, 1953 to the premium payment date of December 12, 1953. Standard complied with the request, and sent peti-

[2] This amount, together with $182.20 petitioner paid to the bank, was deducted by the taxpayer on his 1951 return and was allowed by the Commissioner as an interest deduction under Section 23(b). It is not here in issue.

tioner checks totaling $8,858. On December 9, 1953 petitioner paid Standard $32,814.48, an amount representing a three-year prepayment of interest for the period December 12, 1953—December 12, 1956 upon a loan equal to the cash value the contracts would have on December 12, 1956. Thereupon Standard sent petitioner checks totaling $19,990, thus increasing petitioner's loan from $253,464, the cash value of the contracts on December 12, 1953, to $273,454, the cash value they would have on December 12, 1956. Similarly, on December 10, 1956, petitioner sent Standard checks totaling $11,204.64,[3] a prepayment of interest upon a loan equal to the cash value, $280,117, the contracts would have as of December 12, 1957. Standard again complied, and, accordingly, sent petitioner checks totaling $6,663, representing this cash value increase. On or about December 12, 1957 the cash value of the contracts was set off against the principal amount of the loan, the contracts were canceled, and Standard and petitioner each went their separate ways. Three tables setting forth petitioner's transactions with Standard in the five-year period between December 1951 and the end of December 1956 appear in a footnote.[4] The amounts involved in the present controversy are the $9,784.24 petitioner paid Standard in 1952, and the

[3] The 1956 prepayment of interest is not here in issue. It is unclear whether petitioner claimed a deduction for this prepayment on his return for that year.

[4] 1. *Petitioner's Payments to Standard*

Payment Date	*Amount*	*Nature of Payment*
On or before Dec. 26, 1951	$10,000	Initial annual premium
Dec. 26, 1951	9,596.08	Prepayment of interest on loan for period Dec. 19, 1951 to Dec. 12, 1952
Dec. 1952	9,784.24	Prepayment of interest on loan for period Dec. 12, 1952 to Dec. 12, 1953
Sept. 1, 1953	88.60	Prepayment of interest on loan for period Sept. 1, 1953 to Dec. 12, 1953
Dec. 9, 1953	32,814.48	Prepayment of interest on loan for period Dec. 12, 1953 to Dec. 12, 1956
Dec. 10, 1956	11,204.64	Prepayment of interest on loan for period Dec. 12, 1956 to Dec. 12, 1957

(Footnote continued on following page)

$32,903.28 he paid Standard in 1953 by his checks of September 1 and December 9 of that year. These sums were deducted by taxpayer as "interest paid" on his returns for those years. The Commissioner disallowed the deductions.

These transactions have been recited here, with perhaps wearing detail, in order to clearly set forth the overall arrangement petitioner entered into with Standard in order to obtain deductions from gross income for the purported payment of interest, thereby to reduce his net income and his tax liability. A strong argument based upon Sections 23(b) and 24(a)(6) of the 1939 Code and supported by Section 264(a)(2) of the 1954 Code can be advanced for the proposition that interest paid on loans used to purchase single-premium annuity contracts is deductible from gross income as "interest paid on indebtedness" if the annuity contracts were purchased prior to March 2, 1954. See

(Footnote continued from preceding page)

II. *Standard's Payments to Petitioner (in form of increases in Standard's loan to Petitioner).*

Payment Date	*Amount*	*Date on which cash value of contracts equal to loan*
December 26, 1951	$ 7,749.28	December 24, 1951
September 10, 1953	8,858.00	December 12, 1953
December 11, 1953	19,990.00	December 12, 1956
December 12, 1956	6,663.00	December 12, 1957

III. *Petitioner's Claimed Deductions Expressed as a Percentage of his Out-of-Pocket Costs.**

(a) Taxable Year Ending	*(b) Claimed Deduction***	*(c) Out-of-Pocket Cost**	*(d) (b) as Percentage of (c)*
Dec. 31, 1951	$ 9,596.08	$11,846.80	81%
Dec. 31, 1952	9,784.24	9,784.24	100
Dec. 31, 1953	32,903.08	4,055.08	802
Dec. 31, 1956	11,204.64**	4,541.64	248
Summary over two-year period, 1951-1953	52,283.40	25,686.12	204
Summary over five-year period, 1951-1956	63,488.04**	30,227.76	210

* "Out-of-pocket cost" is here defined as the total payments to Standard minus the total payments by Standard in the form of additional loans to petitioner.

** But see note 3, *supra*

majority opinion in United States v. Bond, 258 F. 2d 577, 582-84 [2 AFTR 2d 5311] (5 Cir. 1958).

Petitioner concedes that one purpose, the primary purpose, of his transactions with Standard was to reduce his income taxes, but he also earnestly contends that these transactions had purposes in addition to the conceded objective. Petitioner has prepared a table demonstrating that if he had confined his "borrowing" to the initial $7,749.28 he borrowed on December 26, 1951 he would have realized a profit of $56,640.16 when the contracts became payable at the end of the forty-first year. But even if this argument is to be taken seriously in view of the length of time involved,[5] the short answer to it is that petitioner in fact did not so limit his borrowing. The effect of his borrowing in 1953 was to reduce this prospective profit to $12,791.20. And his additional borrowing in 1956 reduced an already somewhat ethereal profit down to a meagre $3,463.00 to be enjoyed thirty-six years hence. Petitioner labors hard to persuade us that there is economic substance, or business purpose, here, but we can discern in the overall transaction no possible motive other than one of tax avoidance and no graspable realistic financial benefit other than that.

As indicated in the first paragraph of this opinion, the Tax Court's decision below was based upon its prior decisions in W. Stuart Emmons and Carl E. Weller. These decisions rest upon Gregory v. Helvering, 293 U. S. 465 [14 AFTR 1191] (1935). While Gregory has been most frequently applied in cases where the parties have dealt at

[5] The Government further points out that, even conceding petitioner's assumption of no further borrowing, it would not be until the nineteenth year of the transaction that the annual increase in cash value would exceed the annual interest charge, and it would not be until the thirty-fifth year that surrender values would exceed the total cost.

less than arm's length, as a general principle for construing revenue statutes, see Fairfield S. S. Corp. v. CIR, 157 F. 2d 321, 323 [35 AFTR 117] (2nd Cir. 1946), cert. denied, 329 U. S. 774, we see no obstacle to applying it in the present case. Cf. Lynch v. CIR, 273 F. 2d 867, 870-71 [5 AFTR 2d 361] (2nd Cir. 1959). Precise formulation of the Gregory principle has proved somewhat difficult. There is language in some of our opinions, see Kocin v. United States, 187 F. 2d 707 [40 AFTR 318] (2 Cir. 1951); Slifka v. CIR, 182 F. 2d 345 [39 AFTR 527] (2nd Cir. 1950); CIR v. Transport Trad. & Term. Corp., 176 F. 2d 570 [38 AFTR 365], 572 (2 Cir. 1949), cert. denied, 338 U. S. 955, rehearing denied, 339 U. S. 916, suggesting that Gregory v. Helvering applies to preclude tax relief as to any transaction the taxpayer entered into solely for the purpose of avoiding taxes. Such an application of the holding in that case would be, however, a mistaken oversimplification. The opinion in Gregory v. Helvering permits proper tax avoidance. There it is stated, *supra* at page 469, "[T]he legal right of a taxpaper to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." And as Judge Hand has pointed out in his dissent in Gilbert v. CIR, 248 F. 2d 399, 410, 411 [52 AFTR 634] (2 Cir. 1957), as to many transactions Congress has clearly intended tax relief irrespective of the parties' motives. After surveying our more recent cases the majority stated in Gilbert, *supra*, at pages 403-406, that the principle of Gregory v. Helvering would operate to deny tax relief whenever a transaction was without economic substance or whenever the taxpayer's characterization of the transaction was economically unrealistic. We concluded, *supra*, at 406, "[I]n either case the taxpayer must show that his treatment of the transaction does not

conflict with the meaning the Congress had in mind when it formulated the section *sub judice*." Consistent with the principle we thus set forth in Gilbert, we are of the belief that at the least Gregory v. Helvering requires that a taxpayer carry an unusually heavy burden when he attempts to demonstrate that Congress intended to give favorable tax treatment to the kind of transaction that would never occur absent the motive of tax avoidance. Here it is obvious that petitioner has failed to sustain such a burden.

We have examined petitioner's other contentions which relate to the tax incidents of his payments to Standard; and also his contentions relative to alleged casualty losses. We have found all these contentions to be without merit.

The decision of the Tax Court is affirmed.

MOORE, Circuit Judge (dissenting):

My difficulty with the decision is that the Commissioner and the Tax Court add together a series of perfectly legal acts and come out with illegality as their sum. To me this is not only bad mathematics but unsound legal reasoning. They arrive at this result because they do not regard the purchase of the annuities as a commercially meaningful transaction; to them it was merely a tax scheme. At the same time, they concede that where interest is paid on true annuity indebtedness, the interest is deductible. Despite the fact that the transaction had been carefully planned under the law to take advantage of permissible deductions, governmental taxing authorities, by calling it a "scheme" (a word of evil connotation) assume a paternalistic role to decide whether a taxpayer should, in his particular circumstances, have handled his financial affairs as he did. Such a paternal attitude comes dangerously close to that envisioned (facetiously, I hope) in "1984" (George Or-

well)—a date at the time of writing undoubtedly imaginative but now rapidly approaching.

Review for a moment the position of this taxpayer in 1951. The Standard Life Insurance Company of Indiana offered to sell to the public annuity contracts. The company was legal; the annuity contract was legal. Interest deductions were legal and Congress by its actions in 1932 and 1934 had shown a definite awareness of the annuity indebtedness interest problem by excluding single premium life insurance or endowment contracts but repealing the brief two-year exception as to annuity contracts (see the review of legislative history, United States v. Bond, 5 Cir., 1958, 258 F. 2d 577, 582-584 [2 AFTR 2d 5311]). The taxpayer bought two annuities. Payment of a single premium was legal. The Insurance Company could legally loan up to the cash value of the annuities. Thus, when the loans were made, all steps were legal, actual annuity contracts had been issued, real indebtedness obligations secured by the contracts recorded on the insurance company's books and interest thereon was payable by the taxpayer. How then do the Commissioner and the Tax Court inject lack of reality into a situation which thus far was very real. They find that the taxpayer borrowed the full cash value to pay the premiums. But such a borrowing was legal. If this practice was not wise it was a subject for the various states to consider in revising their insurance laws. They next point to pre-payments of interest for three years at a time when the taxpayer was desirous of offsetting deductions against large capital gains which he had taken. But again this practice is permitted by law. Lastly, they comment on the taxpaper's additional borrowing up to the cash value—a procedure as legal as the original loan.

Of course, it is most obvious that the insurance company in selling, and the taxpayer in buying under the plan for borrowing to pay the premiums, were mindful of the tax advantages resulting from interest deductions. Assume that they had this motive. Tax saving as a motive does not change a "plan" into a "scheme" to fraudulently deprive the government of taxes otherwise due. The Commissioner argues that the interest for 19 years would exceed the contract increment. If wisdom of business judgment is to be the test, then the Commissioner will have to examine into interest paid at 6% on a loan to buy securities paying only 1% or 2% or in many cases nothing at all. Or should interest be disallowed on a large mortgage when the homeowner is shown to have adequate assets to own his home mortgage free. Therefore, to impose on a taxpayer, as does the majority, the burden of showing that the transaction would have occurred "absent the motive of tax avoidance" imputes to Congress an intent which Congress has not yet disclosed.

Congress, however, has in this case disclosed a clear intent that interest on annuity indebtedness now is not to be excepted because in finally reversing its policy of 1934 in 1954, it enacted Section 264 of the Internal Revenue Code of 1954, providing:

> "(a) General rule. No deduction shall be allowed for—
>
> * * *
>
> "Any amount paid or accrued on indebtedness incurred or continued to purchase or carry a single premium life insurance, endowment, or annuity contract. Paragraph (2) shall apply in respect of annuity contracts only as to contracts purchased after March 1, 1954.".

Using only the plain meaning of the words as a guide, the prohibition does not apply to contracts purchased before March 1, 1954, as here. The Commissioner is forced to avoid this obvious conclusion by arguing that even though annuity indebtedness interest was deductible, the transaction lacked reality. At this stage, the argument is back to the point of beginning. The Commissioner is not construing the law but rather imposing his views as to the method of handling the annuity purchase.

I recognize that in Weller v. C. I. R., 3 Cir., 1959, 270 F. 2d 294 [4 AFTR 2d 5453] the Commissioner prevailed on a similar policy, the court rejecting the decision of the Fifth Circuit in United States v. Bond, 5 Cir., 1958, 258 F. 2d 577 [2 AFTR 2d 5311]. The Ninth Circuit has recently affirmed the Commissioner's position in Knetsch v. United States, 9 Cir., 1959, 272 F. 2d 200 [4 AFTR 2d 5855], certiorari granted, 36 U. S. 958 (1960). The rationale of these decisions appears to be based upon the assumption in the dissenting opinion of Judge Wisdom in the Bond case that "since no money or other economic benefits were advanced to the taxpayer by the Company, the payments were not interest." (258 F. 2d 577, 584-585 [2 AFTR 2d 5311]).

But in our present-day commercial system, money is not "advanced" in the sense of delivery. A bank will buy securities for a customer and make a loan against the securities as collateral. The customer usually never sees money or securities. The margin account taxpayer does not take his interest each month and hand it to his broker. His account is debited; his loan thus increased. Here Standard was no different than a lending bank. Its books were subject to audit undoubtedly by one or more governmental agencies. Its premium account was credited when the payment was made just as if the taxpayer had bor-

rowed from a neighboring bank and handed the money through a cashier's window. Under such circumstances the interest would have been deductible. Surely application of the tax laws does not depend upon the source of the borrowing. Here the taxpayer and the Insurance Company were not taking advantage of a statutory loophole. "Loophole" connotes an inadvertent omission or oversight. Congressional action clearly indicates that between 1934 and 1954 interest on annuity indebtedness was intentionally not excluded. Taxpayers should be able to rely on the law. Because the law as to estoppel is apparently well settled in Automobile Club v. Commissioner, 353 U. S. 180 [50 AFTR 1967] (1957) and in Helvering v. N. Y. Trust Co., 292 U. S. 455 [13 AFTR 1184] (1934), I cannot add that upon such non-legal grounds as ordinary fair play they should also be able to place reliance upon the Treasury Department's statements and rulings.

I would reverse as to the interest payments.

APPENDIX B

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the fifth day of July one thousand nine hundred and sixty.

Present: Hon. Charles E. Clark,
Hon. Sterry R. Waterman,
Hon. Leonard P. Moore,
Circuit Judges.

—o—

ROBERT M. DIGGS and CLARA C. DIGGS,
Petitioner-on-Review,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-on-Review.

—o—

Appeals from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

A. DANIEL FUSARO,
Clerk.

APPENDIX C

Statutes Involved

Internal Revenue Code of 1939:

"§ 24. **Items not deductible**

"(a) **General rule.** In computing net income no deduction shall in any case be allowed in respect of—

* * *

"(6) Any amount paid or accrued on indebtedness incurred or continued to purchase a single premium life insurance or endowment contract. For the purposes of this paragraph, if substantially all the premiums on a life insurance or endowment contract are paid within a period of four years from the date on which such contract is purchased, such contract shall be considered a single premium life insurance or endowment contract; * * *."

Internal Revenue Code of 1954:

"§ 163. **Interest**

"(a) **General rule.** There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness."

"§ 264. **Certain amounts paid in connection with insurance contracts**

"(a) **General rule.** No deduction shall be allowed for—

* * *

"(2) Any amount paid or accrued on indebtedness incurred or continued to purchase or carry a single premium life insurance, endowment, or annuity contract.

Paragraph (2) shall apply in respect of annuity contracts only as to contracts purchased after March 1, 1954."

Internal Revenue Code of 1939:

"§ 23. **Deductions from gross income.** In computing net income there shall be allowed as deductions:

"(a) **Expenses.**

* * *

"(2) **Non-trade or non-business expenses.** In the case of an indivdual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * *

"(e) **Losses by individuals.** In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

"(2) if incurred in any transaction entered into for profit though not connected with the trade or business; * * *"